FOX Wealth Management

Quarterly Market Review

September 2017

This review looks at the global investment markets and reports on some of the underlying asset class performance and influences.

Published: 11th October 2017

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Please Note: Past performance is not a reliable indicator of future performance.

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OVERVIEW

Geopolitical Risks remain

The global markets finished the quarter mostly in positive territory. Global shares did well but fixed interest was impacted by rising bond yields and some finished the quarter in negative territory. Global unrest was again a background factor following the unsettling political events unfolding in North Korea. Much of the attention was focussed on:

- President Trump and the promised corporate tax breaks;
- Korea's Kim Jong-un and the latest missile tests; and
- The ongoing conflict and unrest of those who seem bent on disrupting our peaceful society.

Investors remained optimistic about the global recovery encouraged by the recent corporate results reported which were, in the main, mostly as expected. Share market volatility remains relatively subdued which is also encouraging investors to trust the recovery resulting in shares trading with a mild upwards bias.

Monetary Policy

The big news this quarter came from the Federal Reserve Bank (Fed) in the United States. The Fed chair, Janet Yellen indicated that interest rates are still headed north (rising) in response to inflation trends. US inflation is heading towards 2% however, the Fed moves will be tempered and gradual with the next move higher expected sometime towards the end of this calendar year.

The Bank of Japan retained their Quantitative Easing (QE) programme while the European Central Bank is watching the liquidity position and economic data closely for a response following their modified programme of reducing the level of bond support from EUR 80 billion per month to EUR 60 billion per month. Both Central Banks remain committed to stimulating growth in their respective economies.

Growth and Inflation subdued

With all the focus on the political arena, GDP data revealed that growth in the advanced economies is still below what is needed for a stronger recovery. Economists and Government officials are looking for GDP growth of between 2% and 3%, well above what we are experiencing now.

The latest charts for GDP and inflation data reveal:

Chart 1

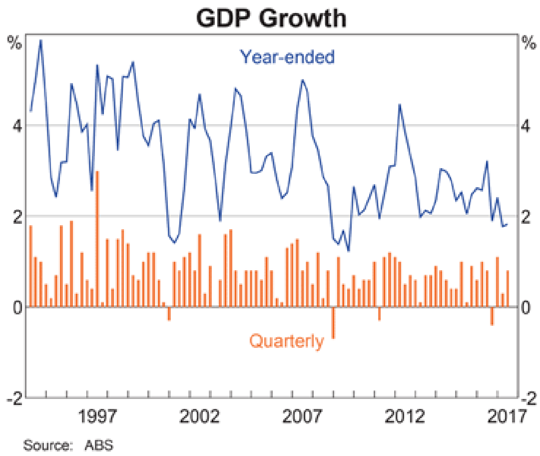
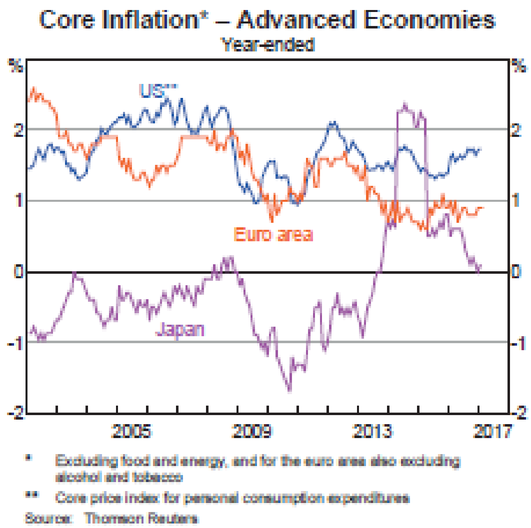


Chart 2

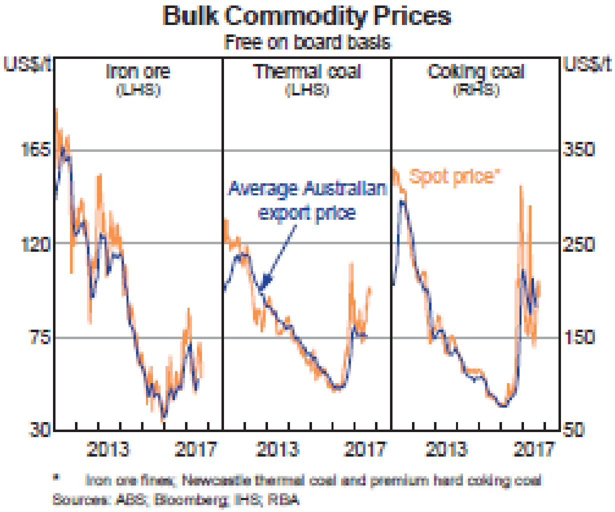


WHAT HAPPENED IN THE MARKETS

The global markets finished on a positive note for the quarter with expectations that the trend will most likely continue in the short to medium term.

Commodity markets recovered from the lows of the previous quarter with the Oil price closing at US $51.67 which was a gain of 12.23% since June 2017 close of US$46.04 a barrel.

Chart 3



Iron Ore bounced from US$56.01 a dry metric ton to a high of US75 at close in August 2017 before settling at US$69.77 in September 2017. This was a gain of some 24.57% over the quarter.

The commodity gains were reflected in the resource company share prices (materials sector) which managed gains of 6.49% in the Australian market.

Regionally, the economic data revealed the following:

- **United States of America**: The US economy in GDP terms to expanded by an annualized 3.1% in the third quarter of 2017. The unemployment rate fell to 4.2%% in September 2017 down from 4.4% in the previous quarter.
- **China** recovered over the quarter with the GDP growth rate coming in at 1.7 %. The annual growth rate year-on-year was unchanged at 6.9 % with the unemployment rate showing further improvement to 3.95% from 3.97%;
- **Europe area** a similar story in Europe with the GDP growth rate improving to 0.6% in September 2017 from 0.5% in the previous quarter. Europe's unemployment rate improved to 9.1% for August 2017 which is encouraging. Core inflation settled at 1.1% in September 2017 slightly lower than 1.2% in August 2017; and
- **Australia's** latest GDP data for the June 2017 revealed the annual growth rate of 1.8 % unchanged from the previous quarter. Unemployment settled at 5.6% or 727,500 persons in August 2017. The CPI finished at 1.9% in June 2017.

ASSET CLASS REVIEW

Growth assets edged higher over the quarter with global shares rewarding patient investors following the corporate reporting season. Investor confidence continues to improve in the US and Europe despite the distractions in North Korea.

Defensive assets recorded mixed results over the quarter as the market watched closely the impact on global interest rates following the steady unwinding of the US QE (quantitative easing) strategy and the introduction of the QT (quantitative tightening) strategy by the Federal Reserve Bank (Fed).

The gradual repayment of the GFC related US QE bond purchases will impact interest rates although most investors are aware of the risks in holding fixed interest investments. The coupons will still be paid but there are risks to the capital from falling bond prices (rising yields). See debt markets comment below.

Table 1

ASSET CLASS	RETURNS		
GROWTH	**3 Months**	**6 Months**	**12 Months**
Global Shares	2.66%	6.57%	16.03%
Australian Shares	0.68%	-0.91%	9.24%
Global Property	1.02%	3.51%	2.32%
Australian Property	1.73%	-1.74%	-2.76%
Global Infrastructure	1.69%	5.76%	12.26%
ASSET CLASS	**RETURNS**		
DEFENSIVE	**3 Months**	**6 Months**	**12 Months**
Global Fixed Interest	0.70%	1.69%	-0.70%
Australian Fixed Interest	-0.07%	0.94%	-0.75%
Australian Cash	0.43%	0.87%	1.76%

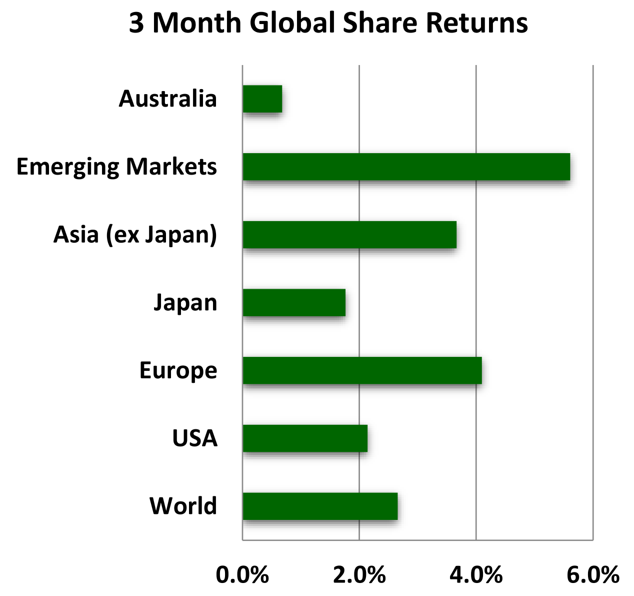
Source Data: Lonsec as at 30th September 2017

Note: The above performance returns reflect total returns in Australian Dollars (prices plus dividends assumed reinvested).

GLOBAL SHARE MARKETS

Global share markets responded well following the company reporting season which proved to be mostly in line with earnings guidance.

Chart 4



Source Data: Lonsec as at 30th September 2017

European share markets were buoyed by the results of the recent elections in Germany and France and remain in consolidation mode. The job market has begun to stabilize but remains very soft with unemployment stuck at 9.1%.

Asia is benefitting from a pick-up in commodity prices which hopefully will lead to an improvement in consumer behaviour.

Emerging markets are benefitting from the bounce in commodity prices along with investment flows into the sector. The developed markets are at or near perceived valuations and are expensive relative to the developing markets.

As China's investment-led economy turns into one driven by consumption, the growth momentum has slowed however, there is more positive news surrounding the impact of China's capital controls is emerging from the region which is providing confidence for investors.

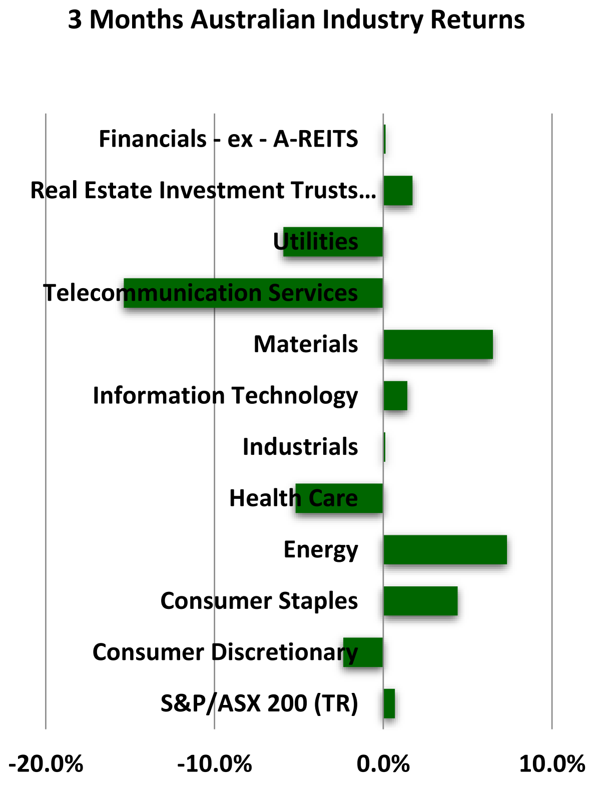
In Japan, despite the efforts to rekindle growth in the economy, core inflation is still quite low but positive at 0.7%. The good news is that the stock market is responding to the stimulus and has generated returns of 11.63% over the past 12 months.

DOMESTIC SHARE MARKETS

The Australian share market (S&P ASX200) posted gains of just 0.68% over the quarter despite the positive global backdrop.

Not all sectors experienced gains with Telecommunication stocks taking a tumble as trends in mobile and fixed-line broadband hit home which is reflective of the heightening competitive pressure evident across all companies in that sector.

Chart 5



Source data – Lonsec as at 30th September 2017

Investors have been engaged in sector rotation chasing growth opportunities as the yield play has made some of the stocks very expensive in terms of price and associated dividend yield.

As mentioned, commodity prices have attracted investment back into the resource companies with the Materials sector up 6.93% and Energy up 7.34% over the quarter. Financial stocks finished up just 0.13% over the quarter as the sector was hurt by heavy weight CBA which fell 9.31% impacted by Austrac issues and internal matters.

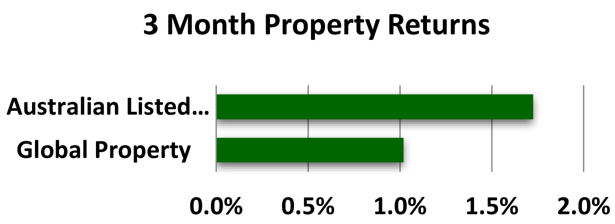
For the rest of 2017 share analysts see the Australian market moving higher with some predicting the S&P/ASX200 to head towards 5,950. With the S&P/ASX200 closing at 5,681 for September 2017, this would put growth estimates for the last quarter at 4.72%.

In terms of dividends, analysts expect defensive stocks to deliver around the 4.5% p.a. which if fully franked at 100% (company tax at 30%) would deliver 6.43% grossed up.

DOMESTIC & GLOBAL PROPERTY

Globally, the property sector posted solid returns as the threat of sharp rising interest rates abated post the Feds announcement on QE tightening. The sector is still attracting investors given the yields and the prospect of capital gains if inflation drives valuations higher.

Chart 6



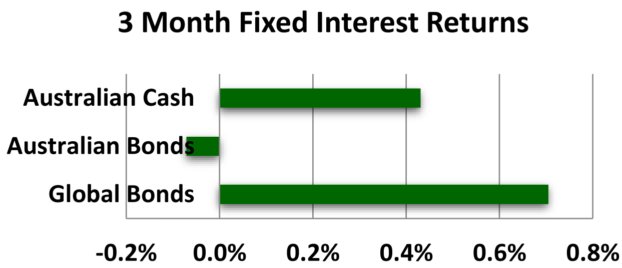
Source Data: Lonsec as at 30th September 2017

The sector however is still concerned about increasing interest rates and the flow-on effects that unhedged borrowings may have on valuations. Post GFC however, most funds have moderate gearing levels with many opting for CPI indexed leases in place to counter any future interest rate rises.

DEBT MARKETS

Global debt markets managed a small positive outcome over the quarter of 0.7%. For Australian bonds, price falls partially offset the income received from bond coupons resulting in a small negative result over the quarter of -0.07%.

Chart 7



Source Data: Lonsec as at 30th September 2017

In the US, the Board of Governors of the Federal Reserve System voted unanimously to maintain the interest rate paid on required and excess reserve balances at 1.25% at their meeting on September 20, 2017. The Fed also voted to initiate the balance sheet normalisation programme which will effectively reduce the liquidity of the short-term money market by not reinvesting all the maturing debt built up over the GFC period. This action will be gradual and did not concern the debt markets as it was in the main, expected.

The US 10-year Government bonds closed at 2.30% for the quarter unchanged from the previous quarter. The Australian Government 10-year bonds finished September at 2.84% up in yield from 2.60% in June 2017. This is a rise of 24 basis points which is equivalent to a fall of 9.18%. This is an example of the market moving interest rates higher while the RBA is on hold. The interest differential between the 10-year US bonds and A$ bonds was 0.54% an increase of 0.10% over the quarter.

The Reserve Bank of Australia retained its monetary policy stance leaving the target cash rate unchanged at 1.5% at the recent board meeting.

Most domestic economists are expecting little to no change in the official cash rate in the medium term.

CURRENCY

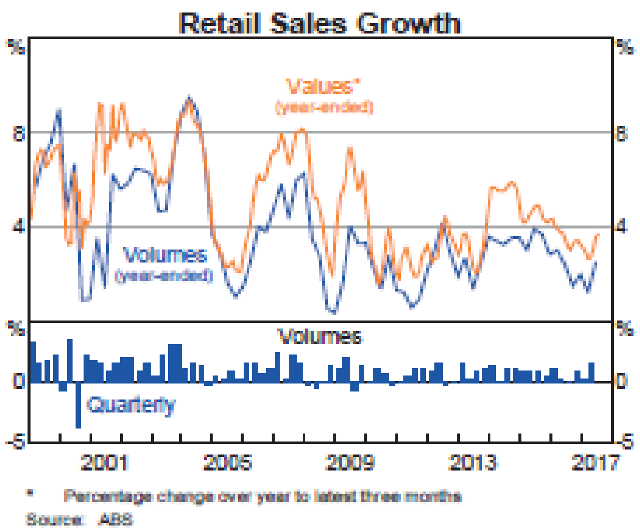
The AUD finished the quarter sharply higher at AUD/USD 0.7839 compared to 0.7692 a gain of 1.91% over the quarter. Currency forecasters see the AUD/USD range between 0.6500 and 0.8500 cents in the medium term.

WHERE TO FROM HERE

Globally the U.S. and European equity markets remain the centre of attention as investor's look for signs of any reason to take profits. Valuations are high in the US but the market keeps on heading higher which is good but bad. Good that investors remain confident of the earnings being achieved by companies but bad if you want to get into the market given that it is at now trading at record highs.

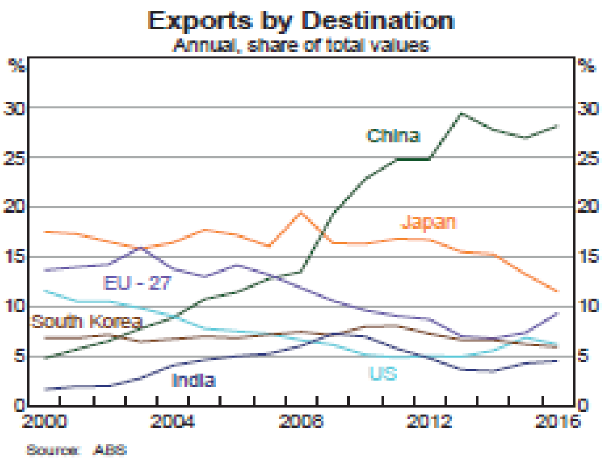
For Australian share investors, the weakening of the Australian dollar back under 80 cents was a blessing for exporters along with the improving commodity prices. Retail sales are still struggling with online activity increasing pressure on traditional bricks and mortar stores.

Chart 8



China still holds the key to the regions recovery. The credit situation and the inventory build-up is a concern however, the annual GDP growth is expected to hold the 6.5%-7.0% level, which will underpin demand for raw materials.

Chart 9



For Australian fixed interest investors, the chase for yield is proving tricky as rising interest rates will impact their capital position. There are debt securities available that are market linked to either the CPI or the Bank Bill Swap rate which will protect investors capital to a degree but they still have credit default risk attached to the underlying bond issuer.

KEY MESSAGE

October is always an interesting month as historically we have seen major share market corrections which will play on investors' minds. The fundamentals however are positive medium term and this will drive market returns.

Looking ahead, we expect that over the medium term, shares will experience earnings growth momentum and the markets will continue their upward bias.

The key factors to watch for are that:

- North Korea avoids any direct conflict with the developed world;
- Central banks in Japan and Europe maintain their QE monetary policy stance and keep interest rates low in their respective regions; and
- The US Fed slowly unwinds the liquidity provided to the cash market throughout the GFC without any adverse changes to interest rates.

If these factors hold over the coming quarter, we should expect to see a better background for equities however a more challenging one for bonds.

DISCLAIMER

The information contained in this review is General Advice, not Personal Advice and does not take into account the investment objectives, financial situation or needs of any person. Past performance is not necessarily an indication of future performance. Future results are impossible to predict.

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Note: The data used in this review was sourced from LONSEC, http://www.lonsec.com.au accessed on the 10th October 2017

Benchmark	Country/Asset Class
MSCI World ex Australia TR Index AUD	Global Shares
MSCI Europe TR Index AUD	European Shares
S&P 500 TR Index AUD	United States Shares
MSCI Japan TR Index AUD	Japan Shares
S&P/ASX 200 TR Index AUD	Australian Shares
S&P/ASX Small Ordinaries TR Index AUD	Australian Small Companies
FTSE EPRA/NAREIT Developed ex Australia NR Index (AUD Hedged)	Global Property
S&P/ASX 200 A-REIT TR Index AUD	Australian Listed Property
S&P Global Infrastructure TR Index (AUD Hedged)	Global Infrastructure
Citi World Government Bond Index (AUD Hedged)	Global Bonds
Bloomberg AusBond Composite 0 Year Index AUD	Australian Bonds
Bloomberg AusBond Bank Bill Index AUD	Australian Cash
MSCI Emerging Markets TR Index AUD	Emerging Markets
Reserve Bank of Australia	Currency

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